Supreme Court, U.S.
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No. 00-

IN THE

Supreme Court of the United States

GEORGE C. PUCKETT, JR. and MARTHA SUE PUCKETT,

Petitioners,

v.

COMMISSIONER OF THE INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

Does a confirmed Chapter 11 bankruptcy plan of reorganization operate: (1) to conclusively establish nondischargeable tax liabilities, and (2) to bar under the doctrine of res judicata a taxpayer's net operating loss deductions specifically allowed and exempted from the application of res judicata by the Internal Revenue Code?

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CITATIONS OF OPINIONS AND ORDERS

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STATEMENT OF BASIS FOR JURISDICTION

The Petitioners seek review of the judgment of the Fifth Circuit Court of Appeals entered on April 12, 2000, for which a motion for rehearing was denied on June 12, 2000. (App. C.) 28 U.S.C. § 1254(1) confers jurisdiction on this Court to review on a writ of certiorari the judgment in question.

PERTINENT STATUTES

11 U.S.C. § 505(a)(1):

> Except as provided in paragraph (2) of this subsection, the court may determine the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax, whether or not previously assessed, whether or not paid, and whether or not contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction.

11 U.S.C. § 507(a)(8)(A):

(a) The following expenses and claims have priority in the following order:

(8) Eighth, allowed unsecured claims of governmental units, only to the extent that such claims are for —

(A) a tax on or measured by income or gross receipts

11 U.S.C. § 523(a)(1)(A):

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt —

(1) for a tax or a customs duty —

(A) of the kind and for the periods specified in section 507(a)(2) or 507(a)(8) of this title, whether or not a claim for such tax was filed or allowed;

11 U.S.C. § 1141(b):

Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.

11 U.S.C. § 1141(d)(2):

> The confirmation of a plan does not discharge an individual debtor from any debt excepted from discharge under section 523 of this title.

26 U.S.C. § 1398(g), as in effect at the time of the Pucketts' bankruptcy case and plan confirmation:

> (g) ESTATE SUCCEEDS TO TAX ATTRIBUTES OF DEBTOR. — The estate shall succeed to and take into account the following items (determined as of the first day of the debtor's taxable year in which the case commences) of the debtor —
>
> (1) NET OPERATING LOSS CARRYOVERS. — The net operating loss carryovers determined under section 172.

26 U.S.C. § 1398(i), as in effect at the time of the Pucketts' bankruptcy case and plan confirmation:

> (i) DEBTOR SUCCEEDS TO TAX ATTRIBUTES OF ESTATE. — In the case of a termination of an estate, the debtor shall succeed to and take into the items referred to in paragraphs (1), (2), (3), (4), (5), and (6) of subsection (g) in a manner similar to that provided in such paragraphs (but taking into account that the transfer is from the estate to the debtor instead of from the debtor to the estate).

26 U.S.C. § 6511(a):

(a) PERIOD OF LIMITATION ON FILING CLAIM. Claim for credit or refund of an overpayment of any tax imposed by this title in respect of which tax the taxpayer is required to file a return shall be filed by the taxpayer within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever of such periods expires the later, or if no return was filed by the taxpayer, within 2 years from the time the tax was paid. Claim for credit or refund of an overpayment of any tax imposed by this title which is required to be paid by means of a stamp shall be filed by the taxpayer within 3 years from the time the tax was paid.

26 U.S.C. § 6511(d)(2)(A):

(A) PERIOD OF LIMITATION. If the claim for credit or refund relates to an overpayment attributable to a net operating loss carryback or a capital loss carryback, in lieu of the 3-year period of limitation prescribed in subsection (a), the period shall be that period which ends 3 years after the time prescribed by law for filing the return (including extensions thereof) for the taxable year of the net operating loss or net capital loss which results in such carryback, or the period prescribed in subsection (c) in respect of such taxable year, whichever expires later. In the case of such a claim, the amount of the credit or refund may exceed the portion of the tax paid within the period provided in subsection (b)(2) or (c),

whichever is applicable, to the extent of the amount of the overpayment attributable to such carryback.

26 U.S.C. § 6511(d)(2)(B)(iii):

(iii) DETERMINATIONS BY COURTS TO BE CONCLUSIVE. — In the case of any such claim for credit or refund or such application for a tentative carryback adjustment, the determination by any court, including the Tax Court, in any proceeding in which the decision of the court has become final, shall be conclusive except with respect to —

(I) the net operating loss deduction and the effect of such deduction, and . . .

STATEMENT OF THE CASE

The Petitioners, George C. Puckett, Jr. and Martha Sue Puckett (the "Pucketts") filed a petition for relief pursuant to Chapter 11 of the Bankruptcy Code on July 8, 1987. The Internal Revenue Service (the "IRS") timely asserted claims in the Pucketts' bankruptcy proceeding for income and employment taxes.[1] The Pucketts' chapter 11 plan was confirmed on April 19, 1991, and treated the IRS' claims as allowed unsecured priority claims and allowed unsecured claims. The amount of the IRS' claims was undisputed, and no claim objection was filed by the Pucketts. Neither the

1. The employment taxes were paid in the Pucketts' bankruptcy case, and are not at issue in this petition for writ of certiorari.

IRS nor the Pucketts sought a tax determination as provided by 11 U.S.C. § 505(a)(1).

The Pucketts subsequently amended their 1985, 1986, 1987, and 1988 federal income tax returns on June 30, 1994, asserting in part, refund claims resultant from a prepetition net operating loss ("NOL") deduction carryover from 1984 and a postpetition NOL deduction carryback from 1989. The 1985, 1986, 1987, and 1988 taxes had been paid through the bankruptcy proceedings on June 30, 1992, or exactly two years prior to the refund claim being asserted.

The IRS ultimately denied the refund claims on the basis that the Pucketts' confirmed chapter 11 plan operated to bar the claims under the doctrine of res judicata. The Pucketts exhausted their administrative remedies, and brought suit in federal district court, alleging jurisdiction under 28 U.S.C. § 1331 and 28 U.S.C. § 1346(a)(1). The district court dismissed the Pucketts' complaint pursuant to Fed. R. Civ. P. 12(b)(6) on the grounds that the confirmed chapter 11 plan precluded the refund claims, also premised on the doctrine of res judicata. The Fifth Circuit Court of Appeals, exercising its jurisdiction pursuant to 28 U.S.C. § 1291, affirmed the decision of the district court.

REASONS FOR GRANTING THE WRIT

The Court of Appeals' application of the doctrine of res judicata in this case directly conflicts with decisions of this Court, and with decisions of the Eleventh Circuit Court of Appeals. The appellate court's holding further discards essential limitations on the preclusive effect of res judicata in a manner that contravenes important and relevant decisions of this Court.

I.

A CONFIRMED PLAN DOES NOT FIX NONDISCHARGEABLE TAX LIABILITIES.

The Fifth Circuit Court of Appeals concluded that the Pucketts' failure to invoke a § 505(a)(1) determination of their tax liabilities or object to the IRS' claim for the subject tax years during the course of the bankruptcy case firmly fixed the amount of their tax liabilities. In reaching this decision, the Court of Appeals correctly noted that the NOL deductions existed during the pendency of the Pucketts' Chapter 11 case. The Court of Appeals reasoned that because the Pucketts failed to avail themselves to the NOL deductions prior to plan confirmation, that the deductions were forever lost, even though the Pucketts timely brought a refund claim predicated on the NOL deductions. 26 U.S.C. § 6511(a) and 26 U.S.C. § 6511(d)(2)(A). The logic applied by the Court of Appeals is flawed and contrary to the decisions of the Eleventh Circuit Court of Appeals in that the mere confirmation of the Pucketts' chapter 11 plan did not irrevocably establish the amount of their tax liabilities, nor did it bar the availability of the NOL deductions.

Generally, a debtor in a bankruptcy proceeding has two available avenues by which to contest a tax claim: a claim objection, or for the debtor or the IRS to move the bankruptcy court for a determination pursuant to 11 U.S.C. § 505(a)(1). *Internal Revenue Service v. Taylor (In re Taylor)*, 132 F.3d 256, 262 (5th Cir. 1998). It is undisputed that the Pucketts did not contest the claim of the IRS in the bankruptcy proceeding, nor did the Pucketts or the IRS seek a § 505(a)(1) determination.

Unlike an objection to a proof of claim, the filing of a plan does not generally initiate a contested matter with respect to a particular claim. *Taylor*, 132 F.3d at 261, citing *Simmons v. Savell (In re Simmons)*, 765 F.2d 547, 552 (5th Cir. 1985). To the contrary, "the plan is like a proof of claim to which objections are filed, thereby instituting contested matters, rather than a vehicle through which objections are made . . . The Code and the Rules do not envision the use of a Plan as a means for objecting to proofs of claims." *Id.*

The *Taylor* court observed that the IRS has the option of remaining outside the bankruptcy proceeding altogether, while preserving claims for debts excepted from discharge, whether or not a claim for such tax was filed or allowed. *Taylor*, 132 F.3d at 261; 11 U.S.C. § 1141(d); 11 U.S.C. § 523(a)(1)(A); 11 U.S.C. § 507(a)(8)(A).

The Bankruptcy Code makes clear in 11 U.S.C. § 1141(d)(2) that the confirmation of a plan of reorganization does not fix tax liabilities made nondischargeable under 11 U.S.C. § 523. *United States v. Gurwitch (In re Gurwitch)*, 794 F.2d 584, 585 (11th Cir. 1986); *Fein v. United States*, 22 F.3d 631, 633 (5th Cir. 1994). Similarly, the confirmation of a plan does not substitute for a § 505 motion any more than it substitutes for an objection to a proof of claim. *Taylor*, 132 F.3d at 263. "The confirmation of a *plan does not itself invoke the tax determination process*". [emphasis supplied] *Id.*

In the case at bar, the Pucketts' tax liabilities consist of federal income taxes, including interest and penalties thereon. These tax liabilities are nondischargeable under 11 U.S.C. § 523(a)(1)(A). In addition, the Pucketts' confirmed chapter 11 plan treated the IRS' claims as nondischargeable. The federal

income taxes were classified as a Class 3 Claim, subject to the following provision:

> TO THE EXTENT THAT THE CLASS 3 CLAIM IS NOT PAID IN FULL, THE INTERNAL REVENUE SERVICE MAY TAKE SUCH ACTIONS AS ARE AUTHORIZED BY THE INTERNAL REVENUE CODE TO ASSESS AND COLLECT ANY UNPAID BALANCE.

The interest and penalties on the unpaid federal income taxes were classified as a Class 7 Claim, and subjected to the following treatment, in anticipation that no funds would be available to satisfy the Class 7 Claim:

> THE INTERNAL REVENUE SERVICE MAY TAKE SUCH ACTIONS AS ARE AUTHORIZED BY THE INTERNAL REVENUE CODE TO ASSESS AND COLLECT ALL PENALTIES AND THE INTEREST OWING THEREON WHICH ARE ATTRIBUTABLE TO THE DEBTOR'S [sic] PRE-PETITION FEDERAL INCOME TAXES AND FEDERAL WITHHOLDING TAXES AND INCLUDED IN THIS PLAN AS A CLASS 7 CLAIM.

Therefore, the Pucketts' tax liabilities were clearly nondischargeable pursuant to 11 U.S.C. § 523, and the Court of Appeals erred in concluding that the liabilities were fixed solely by virtue of plan confirmation.

II.

A CONFIRMED BANKRUPTCY PLAN DOES NOT BAR NET OPERATING LOSS DEDUCTIONS UNDER THE DOCTRINE OF RES JUDICATA.

Res judicata bars the relitigation of issues which were raised or could have been raised in a prior adjudication on the merits by a court of competent jurisdiction. *United States v. Shanbaum*, 10 F.3d 305, 310 (5th Cir. 1994). The Pucketts' claims consist of an NOL carryover and NOL carryback. The Pucketts do not dispute the underlying tax liabilities for the subject tax years, but simply seek a reduction in their substantial tax liability by application of a NOL deduction as provided by statute. 26 U.S.C. § 6511(d)(2)(B)(iii).

In the seminal case concerning res judicata and federal income tax issues, this Court held that a judgment in the prior action operates as an estoppel only as to the actual issues or points in controversy, and upon which the findings or verdict was rendered. *United States v. International Building Co.*, 345 U.S. 502, 505, 73 S. Ct. 807, 808-09, 97 L. Ed. 1182 (1953). In that case, the IRS assessed deficiencies against a taxpayer for the taxable years 1933, 1938, and 1939, alleging that the taxpayer had claimed an excessive basis for depreciation. *Id.* at 503. After the taxpayer filed for bankruptcy, however, the IRS and the taxpayer stipulated in the pending Tax Court proceedings that there was no deficiency for the taxable years in question, and the Tax Court entered a formal decision to that effect. *Id.* at 503-04. Subsequently, the IRS assessed deficiencies for the years 1943, 1944, and 1945, and the taxpayer defended on the ground that the earlier Tax Court decision was preclusive on the issue of the correct basis for depreciation. *Id.* The

court declined to apply res judicata principles, and noted the governing principle as set forth in *Cromwell v. County of Sac*, 94 U.S. 351, 352-53 (1876).

> In all cases, therefore, where it is sought to apply the estoppel of a judgment rendered upon one cause of action to matters arising in a suit upon a different cause of action, the inquiry must always be as to the point or question actually litigated and determined in the original action, not what might have been thus litigated and determined. Only upon such matters is the judgment conclusive in another action.

The *International Building* Court concluded that unless there was an adjudication of the merits, the doctrine of estoppel by judgment would serve an unjust cause: it would become a device by which a decision not shown to be on the merits would forever foreclose inquiry into the merits. *International Building*, 345 U.S. at 506. This Court recently applied the same principles enumerated in *International Building*, as being illustrative of the application of res judicata. *Arizona v. California*, 120 S. Ct. 2304, 2313, 147 L. Ed. 2d 374, 384 (U.S. 2000). Thus, unless the court conducts an actual adjudication on the merits, res judicata cannot be used as an absolute bar to issues which might have been litigated.

Similarly, the Eleventh Circuit Court of Appeals held that a bankruptcy court failed to make adequate inquiry into issues actually resolved by prior state court litigation, and thus a preclusive effect could not be accorded to the state court judgment until a full inquiry was made determining what issues were actually resolved by that judgment. *Balbirer v. Austin*, 790 F.2d 1524, 1525 (11th Cir. 1986). In direct

conflict with the decisions of this Court, and the Eleventh Circuit's holding in *Balbirer*, the Fifth Circuit Court of Appeals has given a broad-sweeping preclusive effect to a confirmed bankruptcy plan, in the complete absence of litigation or controversy.

In the instant case, no inquiry was made into the merits. The IRS filed claims without objection, and the chapter 11 plan was confirmed. In fact, no justiciable controversy existed. The Pucketts do not dispute the underlying tax liabilities; they simply seek the benefit of a timely-asserted NOL deduction as allowed by statute.

III.

NOL CARRYOVERS AND CARRYBACKS SUBSEQUENT TO BANKRUPTCY PROCEEDINGS ARE STATUTORILY PROVIDED FOR.

26 U.S.C. § 1398(g), as in effect at the time of the Pucketts' bankruptcy case and plan confirmation, provided that a debtor's bankruptcy estate succeeded to the tax attributes of the debtor, including net operating loss carryovers determined under section 172 of the Internal Revenue Code. Similarly, 26 U.S.C. § 1398(i), as in effect at the time of the Pucketts' bankruptcy case and plan confirmation, provided that upon the termination of the debtor's bankruptcy estate, the debtor would succeed to the tax attributes of the estate. Finally, 11 U.S.C. § 1141(b) provides in relevant part that except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.

The plain language of the statutes cited above evidences a Congressional intent to legislate specific rules applicable to NOL carryovers for individual Chapter 11 debtors. Indeed, the opening section of § 1398 states that it applies to "any case under chapter 7 . . . or chapter 11 . . . of title 11 of the United States Code in which the debtor is an individual." Further, 11 U.S.C. § 1141(b) read in conjunction with 26 U.S.C. § 1398(i) makes clear that NOL carryovers become the property of the individual debtor upon termination of the Chapter 11 estate.

Congress indicated a further intent to treat NOL deductions differently from other tax attributes by the language of 26 U.S.C. § 6511(d)(2)(B)(iii), which reflects Congress' intent that the normally preclusive effect given to a court's prior adjudication does not apply with respect to NOL deductions. In essence, the legislature carved out an exception to the doctrine of res judicata with regard to NOL deductions. The Pucketts' refund claims premised on NOL deductions fall squarely within the statutorily-contemplated exception. Sections 1398(g) and 1398(i) provide for the orderly flow of tax attributes from the debtor to the estate and then back to the debtor upon termination of the estate, and specifically address the treatment of NOL deductions. The claims at issue center around a carryover of a 1984 NOL to apply against a 1985 tax liability, and a 1989 NOL carryback to extinguish a 1987 tax liability and reduce a 1988 tax liability. Whether or not the Pucketts' claimed NOL deductions could or should have been litigated within the bankruptcy case is not relevant in light of § 6511(d)(2)(B)(iii). The Pucketts seek a refund based on NOL deductions: § 6511(d)(2)(B)(iii) provides that no final decision of any court shall be conclusive with respect to NOL deductions.

More importantly, however, this Court has held that in the absence of an actual determination on the merits, res judicata may not bar issues which might have been litigated. *International Building*, 345 U.S. at 505-06. Thus, the Court of Appeals erred in holding that the Pucketts' confirmed bankruptcy plan operated to forever foreclose the availability of net operating loss deductions provided for by statute.

CONCLUSION

The Court of Appeals erred in holding that the confirmation of a bankruptcy plan conclusively determines the amount of a debtor's nondischargeable tax liabilities, and precludes the allowance of net operating loss deductions through the application of the doctrine of res judicata. Thus, the judgment of the Court of Appeals should be reversed and remanded.

Respectfully submitted,

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